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No. 06-1413

IN THE

Supreme Court of the United States

THE MEADWESTVACO CORPORATION,
SUCCESSOR IN INTEREST TO THE
MEAD CORPORATION,
Petitioner,

v.

ILLINOIS DEPARTMENT OF REVENUE,
DIRECTOR OF THE ILLINOIS DEPARTMENT
OF REVENUE, AND TREASURER OF
THE STATE OF ILLINOIS,
Respondents.

On Writ of Certiorari
to the Appellate Court of the State of Illinois

BRIEF OF MULTISTATE TAX COMMISSION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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BRIEF OF MULTISTATE TAX COMMISSION as *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS[1]

INTEREST OF *AMICUS CURIAE*

Amicus Curiae Multistate Tax Commission ("the Commission") files this brief in support of Respondents, the Illinois Department of Revenue, the Director of the Department of Revenue and the Treasurer of the State of Illinois ("the State"). The Commission believes the decision below must be affirmed because the Petitioner, MeadWestvaco, Inc. ("the Taxpayer"), has failed to meet its "distinct burden of showing by 'clear and cogent evidence'", *Exxon Corporation v. Wisconsin,* 447 U.S. 207, 221 (1980), that the State imposed a tax on income earned outside of its borders when it apportioned income from the sale of its business segment which operated within the State. Because there is far more than the requisite "minimal connection" or "rational relationship", *Mobil Oil v. Commissioner of Taxes (Vermont),* 445 U.S. 425, 426-7 (1980), between the interstate activities conducted by the Taxpayer's unitary business in Illinois and the gain resulting from the sale of the assets used in that unitary

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[1] No counsel for any party authored this brief in whole or in part. Only *amicus* Multistate Tax Commission and its member states through the payment of their membership fees made any monetary contribution to the preparation or submission of this brief. This brief is filed by the Commission, not on behalf of any particular member State. Finally, this brief is filed with the consent of the parties.

business, the assessment of tax at issue in this matter should be sustained.

The Commission is the administrative agency charged with implementing and furthering the goals of the Multistate Tax Compact ("Compact"), which became effective in 1967. *See* RIA ALL STATES TAX GUIDE ¶ 701 *et seq.*, (2005). Today, forty-seven states and the District of Columbia are members of the Commission. Twenty have legislatively established full membership. Seven are sovereignty members and twenty-one are associate members.[2] This Court upheld the validity of the Compact in *United States Steel Corp.* v. *Multistate Tax Commission*, 434 U.S. 452 (1978).

The purposes of the Compact are to: (1) facilitate proper determination of State and local tax liability of multistate taxpayers, including equitable apportionment of tax bases and settlement of apportionment disputes, (2) promote uniformity or compatibility in significant components of tax systems, (3) facilitate taxpayer convenience and compliance in

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[2] Compact Members: Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington. Sovereignty Members: Georgia, Kentucky, Louisiana, Maryland, New Jersey, West Virginia and Wyoming. Associate Members: Arizona, Connecticut, Florida, Illinois, Iowa, Indiana, Maine, Massachusetts, Mississippi, Nebraska, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont and Wisconsin.

the filing of tax returns and in other phases of tax administration, and (4) avoid duplicative taxation.

These purposes are central to the very existence of the Compact, which was the States' answer to an urgent need for reform in State taxation of interstate commerce. *See e.g.*, H.R. Rep. No. 952, 89th Cong. 1st Sess., Pt. VI, at 1143 (1965).[3] The promise of increased uniformity established by the States' adoption of the Compact was critical to preserving the recognized sovereignty the States enjoyed, and continue to enjoy, with respect to taxation of interstate commerce. Preserving state tax sovereignty under our vibrant federalism remains a key purpose of the Commission.

The Commission attaches great importance to the present case precisely because the Taxpayer's arguments, if accepted, would greatly undermine this goal of preserving the States' authority to determine their own tax policies within federal constitutional and statutory limitations. In particular, the Commission is vitally concerned with the preservation of the States' constitutionally permitted use of formulary apportionment methods to fairly measure in-

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[3] The Willis Committee Report, a congressional study of state taxation mandated by TITLE II OF PUB. L. NO. 86-272, 73 STAT. 555, 556 (1959), made extensive recommendations as to how Congress could regulate state taxation of interstate and foreign commerce. *See generally Interstate Taxation Act: Hearings on H.R. 11798 and Companion Bills Before Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary*, 89th Cong., 2d Sess. (1966).

come generated from economic activity taking place within their borders. The capital gain at issue in this case was realized upon the sale of assets that performed an integral operational function in the Taxpayer's unitary electronic publishing business ("Lexis/Nexis"), a business division that operated continually in Illinois at least since the mid-1980's. Record Vol. 1, C244. The Taxpayer does not dispute Illinois' right to tax income generated from Lexis/Nexis (*Plaintiff's Post-Trial Reply Brief*, Record Vol. 8, C1881-2), but contends that Illinois cannot tax the gain resulting from the sale of the assets of that business segment because the sale itself was "an out-of-state event" (Brief of Petitioner ["Pet. Br."], p. 29) by a separate line of business ("Mead Paper") that also operated within Illinois. Under this Court's precedents upholding the principles of source-based taxation, the States have the ability to tax a fairly apportioned share of the gain from the sale of assets located within their borders, even though the sale is consummated out-of-state and even though the gain on the sale is realized by a Taxpayer who is also engaged in a second and arguably unrelated line of business in the State.

Because of this direct and undeniable operational connection between the assets from which the capital gain arose and the unitary business (Lexis/Nexis) with activities in the taxing State, the contours of the operational test for apportionment of income established by this Court in *Allied-Signal v. Director, Division of Taxation*, 504 U.S. 768 (1992) have been fully met. Even though, in this case, the capital gain income was included in the combined

apportioned income of the Taxpayer's two business segments, there is no claim that Illinois' apportionment method actually resulted in taxation of extraterritorial values. No such claim could be made because the gain arose from the activities of Lexis/Nexis, a business segment which operated continuously in Illinois, and in addition, the two lines of business had nearly identical apportionment factors within the State. The Commission accordingly believes it is unnecessary, in this controversy, to determine whether the gain could also have been subject to apportionment under the principles announced in *Allied-Signal, supra,* based on the assets' operational relationships with Mead Paper.

Where the capital gain at issue in this case was generated by a business conducting operations partially within the taxing State, and where there is no claim that the State's taxation of that gain has reached income generated beyond its borders, the sole remaining question is whether Illinois' tax constitutes a permissible burden on interstate commerce under the standards announced by this Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). The Commission believes Illinois' tax easily meets all four prongs of the *Complete Auto* test: (a) it is a tax upon activity with a substantial nexus to the taxing State; (b) it is fairly apportioned; (c) the tax is non-discriminatory; and (d) the tax is fairly related to benefits and protections afforded by the State. 430 U.S. at 279-80.

The Court should use the opportunities afforded by this case to reinforce its long-standing

commitment to the States' power to tax based upon the substance of how and where income is earned, as measured by formulary apportionment. The Commission thus urges this Court to reject the Taxpayer's invitation to abandon those precedents in favor of a return to the formalisms which characterized Commerce Clause and Due Process adjudication in the early part of the previous century.

SUMMARY OF ARGUMENT

The State of Illinois properly taxed an apportioned share of the capital gain recognized on the sale of the assets used in the Taxpayer's electronic publishing division (Lexis/Nexis), a unitary business which operated partially within Illinois. The assets which were sold—Lexis/Nexis' tangible property and the goodwill of the business—performed an integral operational function for that unitary business. Together, these factors establish Illinois' right to tax that share of the capital gain which can reasonably be attributed to values generated within the State. Properly apportioning the gain in accordance with Lexis/Nexis' factors results in approximately 4% of the gain being attributed to Illinois.

Even if Lexis/Nexis did not have such a direct presence within the State, Illinois would have the ability to include the capital gain in the Taxpayer's apportionable income tax base in two circumstances. First, the scope of the Taxpayer's unitary business with which the Lexis/Nexis assets were operationally connected could be defined to encompass both the

Taxpayer's paper manufacturing, sales and office supply business segment (Mead Paper), which also had activities in the State, and Lexis/Nexis. In that case, the gain would be properly apportioned with the income and factors of the two business segments combined; that calculation would apportion approximately 4% of the gain to Illinois.

Alternatively, even if the two business segments were not fully unitary, an operational connection between the Lexis/Nexis assets and the Mead Paper business segment alone would justify apportionment of income received from the sale of the Lexis/Nexis assets, using the income and factors of the Mead Paper business segment for purposes of apportionment. That calculation would also apportion approximately 4% of the gain to Illinois.

No matter how the scope of the unitary business is defined, it yields a business which operated in Illinois. While these different approaches to defining the unitary business could lead to different reporting consequences for state law purposes, the State's ability to tax a fairly-apportioned share of the gain does not change. No matter how the unitary business is defined in this case, a portion of its activity which generated the gain was carried on in Illinois. Where the tax liabilities under each methodology are nearly indistinguishable, foreclosing any claim of extra-territorial taxation, the determination of whether the gain should have been apportioned separately or in combination is essentially an academic exercise.

The Illinois Court of Appeals found that Lexis/Nexis' assets served an operational function for the Taxpayer within the State, including its Mead Paper business segment. While this Court need not reach the merits of that determination in order to uphold the assessment of tax in this case, the precedents of this Court firmly hold that such judgments are entitled to deference unless clearly unreasonable. Substantial evidence supports the lower court's determination that the Lexis/Nexis assets served an operational function for the Mead Paper business and that Lexis/Nexis was not merely a passive investment activity. The lower court's judgment should not be reversed absent overwhelming evidence to support a contrary conclusion.

The Taxpayer and its *amici* have also presented numerous policy arguments to support their position, most notably the potential for duplicative taxation, because, if their view of the facts and law were accepted, the Taxpayer's state of commercial domicile would have a right to tax such income under state law. (There is no claim in the case that the Taxpayer actually allocated this gain to Ohio, its commercial domicile, or that Ohio law would actually favor such allocation.) This Court's precedents clearly establish a preference for apportionment, rather than allocation, of unitary business income. And, properly sourcing this gain as apportionable unitary business income based upon Lexis/Nexis' presence in the taxing State, as Illinois has done, eliminates the potential for duplicative taxation.

ARGUMENT

ILLINOIS PROPERLY TAXED AN APPORTIONED SHARE OF THE CAPITAL GAIN ARISING FROM THE SALE OF ASSETS LOCATED WITHIN THAT STATE

The sole question before this Court is whether the State of Illinois offended either the Due Process Clause (Amend. XIV) or the Commerce Clause (Art. I, § 8) of the U.S. Constitution when it taxed an apportioned share of a capital gain realized from the sale of the assets of a business segment which operated within Illinois.

A State tax runs afoul of these constitutional restrictions only if it reaches income which clearly has its source beyond the State's borders. *Allied-Signal, Inc. v. Director, Division of Taxation,* 504 U.S. 768, 778 (1992). In previous decisions of this Court, that requirement has been variously described as necessitating "a minimal connection, or nexus between the [Taxpayer's] interstate activities and the taxing State", *Exxon Corporation v. Wisconsin Department of Revenue,* 447 U.S. 209, 219-220 (1980), and "a rational relationship between the income attributable to the taxing State and the intra-State values of the enterprise." *Mobil Oil Corporation v. Commissioner of Taxes of Vermont,* 445 U.S. 425, 436-7 (1980). The taxpayer asserting the invalidity of a tax "has the distinct burden of showing, by 'clear and cogent evidence' that [the State tax] results in extra-territorial values being

taxed..." *Butler Brothers v. McColgan,* 315 U.S. 501, 507 (1942).

The record in this case reveals very clearly that Illinois has not taxed income earned beyond its borders by taxing an apportioned share of the income realized from the sale of the assets of a unitary business which operated within the State.

A. The Assets Giving Rise To This Capital Gain Were Functionally Connected To The Taxpayer's Unitary Business Conducted in Illinois; The Assets Were Not Held As Passive Investments.

In the present case, the Taxpayer's Lexis/Nexis segment carried on substantial business within Illinois for years, operating sometimes as a division, and sometimes as a separately-incorporated subsidiary. J.A. 14.[4] In 1993, for instance, Lexis/Nexis had $4,406,947 in tangible property located within the State, $40,757,730 in sales, and paid its employees in Illinois $4,095,601 in wages. J.A. 189. While the Taxpayer conceded in the case below (Record Vol. 8, C1881-2) that Illinois would have the right to tax the income earned by Lexis/Nexis, it now contends that a different rule ap-

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[4] The decision to operate as a division or subsidiary was dictated in each instance by the Taxpayer's desire to lower its overall state tax liability. J.A. 14. Thus, in 1993 the Taxpayer decided to merge the corporations under which Lexis/Nexis conducted business back into Mead Paper so that Mead Paper could fully utilize net operating losses. Record Vol. 9, C1872; J.A. 134; 147.

plies to the taxation of the capital gain arising from the sale of that portion of the income-producing assets located in Illinois.

Nowhere in the Petitioner's Brief is there any attempt to identify where this gain arose from an economic standpoint, nor is there any attempt to explain why the State should not be able to tax a gain recognized on the sale of assets located within its borders. (In fact, the Taxpayer never mentions that Lexis/Nexis had a presence in Illinois at the time of the sale, nor that it did business in Illinois for at least nine years prior to that sale.)

Although the Taxpayer acknowledges that the prohibition of extra-territorial taxation lies at the heart of this Court's precedents applying the unitary business principle (Pet. Br. 20-24), it never applies that analysis to the facts of this case. In particular, the Taxpayer provides no authority for its oblique suggestions (Pet. Br. 21, 29) that the only taxable economic activity associated with a $1.05 billion gain was the sales transaction itself, and indeed it does not even identify where that transaction took place.

Because the Taxpayer omits any mention of Lexis/Nexis' Illinois presence, its brief provides no explanation for how the 1993 merger of Lexis/Nexis back into the Mead Corporation stripped Illinois of the ability under the Due Process Clause or Commerce Clause to tax the capital gain arising from the sale of these assets. One assumes that the Taxpayer would not contest Illinois' right to tax Lexis/Nexis on an apportioned basis had it sold some

of its assets while conducting business in Illinois as a separate entity. Once Lexis/Nexis was merged back into the Mead Corporation, Mead Corporation became the only entity which Illinois could have subjected to taxation unless the State chose to completely de-conform from federal tax standards.

The gravamen of Taxpayer's argument appears to be that the 1993 merger converted Lexis/Nexis' apportionable income into Mead Corporation's passive investment income. As investment income, the Taxpayer contends, the gain may only be taxed as a *constitutional* matter in the state of its commercial domicile, Ohio. Pet. Br. 50-53. The argument that the form in which income is recognized precludes its taxability was foreclosed in *Mobil Oil,* 445 U.S. 425 (1980):

> It remains to be considered whether the form in which the income was received serves to drive a wedge between Mobil's foreign enterprise and its activities in Vermont... Mobil has attempted to characterize its ownership and management of subsidiaries and affiliates as a business distinct from its sale of petroleum products in this country. ...
>
> At the outset, we reject the suggestion that anything is to be gained from characterizing the receipt of dividends as a separate taxable event. In *Wisconsin v. J.C. Penney Co., supra,* the Court observed that 'tags' of this kind 'are not instruments of adjudication but statements of result,'

> and they add little to the analysis. 311 U.S., at 444. Mobil's business entails numerous 'taxable events' that occur outside Vermont. That fact alone does not prevent the State from including income earned from those events in the pre-apportionment tax base.
>
> Nor do we find particularly persuasive Mobil's attempt to identify a separate business in its holding company functions. ....One must look principally at the underlying activity, not the form of investment, to determine the propriety of apportionability.

445 U.S. at 440. *Accord, ASARCO, Inc. v. Idaho State Tax Commission,* 458 U.S. 307, 330 (1982). The fact that Lexis/Nexis became one of two divisions of a single corporation a few months before its assets were sold presents no constitutional issues with respect to Illinois' right to tax a portion of that income based upon its source. By the same token, the fact that the capital gain could have been subject to apportionment as the "unitary" income of one of two separate business segments presents challenges of tax administration for Illinois, but does not add a constitutional dimension in this case, since under each scenario approximately the same percentage of the business' activity was conducted in Illinois and thus yields the same apportioned tax liability.

There is no dispute in this case that Lexis/Nexis was itself a unitary business operating in Illinois, and the assets which were sold (the tangi-

ble and intangible property of the entire business) were "operationally connected" to that business. Thus, the gain had a sufficient "nexus" to Illinois to allow apportionment by that State under *Allied-Signal*. As set forth below, these assets may alternatively have had an operational connection to Mead Paper, or to both Mead Paper and Lexis/Nexis if the scope of the unitary business operating in Illinois includes both business segments. See *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 167 (1983)(noting that many variations of the unitary business concept "...are logically consistent with the motivations underlying the approach."). In this case, the different possibilities for defining the scope of the unitary business do not affect the ability of the State to impose an apportioned tax on the gain, nor do they result in different apportionment percentages. In this case, the different possibilities for defining the scope of the unitary business result in nearly identical tax outcomes.

1. The Scope of the Taxpayer's Unitary Business Conducted in Illinois Encompasses Lexis/Nexis, And Could Also Include Mead Paper.

The Lexis/Nexis assets were operational with a unitary business conducted by the Taxpayer in Illinois. Three possibilities exist for identifying and defining the scope of that unitary business: (a) the Taxpayer's paper and office supply business segment (Mead Paper) and the Taxpayer's electronic publishing segment (Lexis/Nexis) as constituting a single unitary business; (b) an operational connection

between Mead Paper and Lexis/Nexis; and (c) the Lexis/Nexis division and Mead Paper as completely independent. The different possibilities for analyzing the scope of the unitary business do not affect the ability of the State to impose its tax in this case, or the measure of that tax, for in all three instances Illinois' ability to tax the income is coextensive with the amount of income generated within the State.

a. Lexis/Nexis and Mead Paper as a Single Unitary Business. The Taxpayer filed all of its State corporate income tax returns in Illinois from 1988 through 1994, the year the gain was recognized, as if Mead Paper and Lexis/Nexis were fully unitary. Although the Taxpayer now claims the two business segments were non-unitary,[5] it made no effort to separately report the income and expenses of its two business segments and subject that income to separate apportionment calculations. See, e.g., Record Vol. 9, *Report of Proceedings*, C240-241; *Cf., Amerada Hess, Inc. v. Director, Division of Taxation*, 490 U.S. 66 (1989)(windfall profits tax on oil production were expenses of the Taxpayer's unitary energy

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[5]The Petitioner's Brief states that the Taxpayer "had filed, under protest, a tax return as a unitary business at the directive of the Illinois Department of Revenue." Pet. Br. 12. The record reflects that the Taxpayer agreed, as part of an audit settlement, not to contest the Department's decision to treat the two businesses as unitary for the 1984-1985 tax years. Record Vol. 1, C244. Nothing in the record supports the contention that the Taxpayer's decision to continue filing that way for the next eight years was compelled by the State; in fact, Lexis/Nexis was merged back into the Taxpayer in order to secure state tax advantages which would only accrue to a unitary combined filer. J.A. 147.

business and could not be separately sourced to locations where oil was extracted).

b. Lexis/Nexis and Mead Paper as Operationally Connected Business Segments. The facts in this case could also support a finding that Mead Paper and Lexis/Nexis were not a single unitary business, but the assets of Lexis/Nexis were operationally or functionally connected to one or the others' separate unitary businesses in Illinois.

In *Allied-Signal,* 504 U.S. at 787, this Court explained the concept as follows:

> We agree that the payee and payor need not be engaged in the same unitary business as a prerequisite to apportionment in all cases. *Container Corp.* [*of America v. Franchise Tax Board,* 463 U.S. 159 (1983)] said as much. What is required is that the capital transaction serve an operational rather than an investment function.

Under this analysis, the apportionable income of the Taxpayer would include the income derived from the operationally-connected source.[6] The opera-

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[6] Receipt of income from an operationally-connected source would generally not justify inclusion of the factors of the payor in the apportionment formula. (For instance, in the case of interest received from investment of short-term capital, the apportionment formula would not include a percentage of the payor's factors.) In the present case, the Taxpayer combined the factors of Lexis/Nexis with Mead Paper's factors, and the State did not contest that treatment. Record Vol. 4, C850. The

tional connection between income source and income recipient is the justification for apportionment upheld by the Illinois Court of Appeals in the case below. Pet. App. 18a. As set forth in the Respondent's Brief, the evidence of interdependence between the two segments is substantial. Rep. Br. 1-8; 25-29.[7]

c. Lexis/Nexis and Mead Paper as Distinct Business Segments. The third possibility is that the two business segments were not unitary and the assets of the Lexis/Nexis segment were not operationally or functionally connected at all. In such a situation, the unitary business income of the two business segments should be separately apportioned according to their separate factors on a *pro-forma* return.

2. Apportioning the Gain to a Single Unitary Business or to One of Two Separate Unitary Businesses Does Not Affect the Amount of the Gain Subject to Illinois' Tax in this Case.

Correctly defining the parameters of the unitary business(es) doing business in the State is a critical step for ensuring that the State's tax bears "a rational relationship...to the intrastate values of the

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State did adjust the sales factor of the apportionment formula by including the gain in the denominator and increasing the numerator by approximately $40 million to reflect that portion of the gain attributable to Lexis/Nexis' intangible property located within the state. J.A. 184-188.

[7] In fact, the Taxpayer suggested in its answers to interrogatories that it was impossible to separate the income and expenses of the two business segments for years in which they were merged into a single entity. Record Vol. 1, C245, 248-249.

enterprise." *Mobil Oil*, 445 U.S. at 436-7 (1980). Where the unitary business could reasonably be defined to encompass either a single business segment or multiple segments, different tax consequences may arise from the fact that each business segment will likely have different in-state apportionment percentages. In the present case, however, the outcomes are not significantly different because the Illinois apportionment percentages for the Taxpayer and Lexis/Nexis are almost identical. Using Illinois' four-factor formula, which double-counts the sales factor, Lexis/Nexis' apportionment percentage in Illinois for 1993[8] was 4.7056%, slightly higher than the Taxpayer's average apportionment percentage of 4.1134%. Record Vol. 1, 154; J.A. 189.[9] Because Lexis/Nexis' Illinois' apportionment percentage was a fraction of a percentage higher than Mead Corpora-

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[8] Lexis/Nexis' 1993 factors were used by the State's auditor to adjust the sales factor to apportion some of the capital gain to Illinois because those were the latest numbers available. Record Vol. 9, *Report of Proceedings*, C234.

[9] The Illinois apportionment percentages for the two business segments would not change materially if an equally-weighted three-factor apportionment formula was employed instead of the four-factor formula. See *Container Corporation*, 463 U.S. at 170 (describing the three-factor formula as "something of a benchmark against which other apportionment formulas are judged."). The factors of Mead Corporation (including Lexis/Nexis) and Lexis/Nexis separately were:

Mead Corp. Factors (1994):	Lexis/Nexis Factors (1993):
Property: 2.002%	Property: 1.4166%
Payroll: 2.9664%	Payroll: 2.1629%
Sales: 5.7426%	Sales : 7.6215%
Total: 10.711%	Total: - 11.201%
Average:3.5703%	Average: 3.7336%

tion's, the Taxpayer would have had a higher overall tax liability had Illinois treated the Lexis/Nexis business segment as a separate line of business from Mead Paper.

B. The Value Being Taxed In This Case Is The Appreciation of Lexis/Nexis' Assets, Particularly Its Goodwill; Those Assets Were Partially Located In Illinois.

It is axiomatic that in order for a State to have jurisdiction to impose a tax there must be "some definite link, some minimum connection, between the State and the person, property or transaction it seeks to tax." *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-5 (1954); *Exxon v. Wisconsin*, 447 U.S. at 229. *J.C. Penney Corp. v. Wisconsin, 311 U.S. 435 (1940); International Harvester v. Wisconsin*, 322 U.S. 435, 446 (1944).

Whether a portion of this capital gain can be taxed by Illinois thus turns on whether the interstate activities sought to be taxed (the realization of a gain on a business which had been developed and nurtured in multiple States, including Illinois) bears some rational relationship or minimal connection to the taxing State. *Mobil Oil*, 445 U.S. at 436-7. It was the Taxpayer's burden in this case to demonstrate that there was no such rational relationship between the apportioned tax imposed by Illinois on the gain and the "opportunities...protection[s]...and benefits" afforded by the State. *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444. The Taxpayer did not meet this burden. Indeed, by ignoring Lexis/Nexis'

presence in the State it has all but abandoned the point before this Court.[10]

In this case, the capital gain of $1.05 billion arose from the sale of the Taxpayer's unitary electronic publishing division, Lexis/Nexis, including tangible and intangible property.[11] The intangible property at issue here was the business goodwill of Lexis/Nexis, that is, the value of the business as a going concern over and above the book value of its tangible property. *See, e.g., Newark Morning Ledger v. United States*, 507 U.S. 546, 555 (1993); *United States v. Winstar Corp.*, 518 U.S. 839 (1996). In the case of Lexis/Nexis, goodwill represented the willingness of customers to continue to subscribe to Lexis/Nexis databases, and the willingness of its employees to continue to apply their skills and experience. Lexis/Nexis had fifty sales offices throughout the world charged with generating and maintaining

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[10] The Taxpayer did claim in the proceedings below that apportionment of the gain would result in an overstatement of its earnings in the State, based on a separate accounting analysis. Record Vol. 1, C92; Vol. 8, C1922. The trial court rejected the distortion claim. Record, Vol. 8, C1925-6. The Taxpayer now argues only that Illinois' taxation of the gain would result in a "misattribution of taxable income" between domiciliary and non-domiciliary states (Pet. Br. 49), but does not demonstrate how the gain arose from economic activity occurring in Ohio, the Taxpayer's domicile. The Taxpayer's current argument appears to be limited to the claim that domiciliary states might also seek to tax such income as a matter of state law. Pet. Br. 48-53.

[11] Although the Taxpayer's brief focuses on the tax treatment of the intangible property, it is not clear whether the Taxpayer concedes that a portion of the gain attributable to Lexis/Nexis' tangible property ($126,455,018 (J.A. 189)) should have been allocated to Illinois. *Compare*, Record Vol. 1, C93 and Record Vol. 9, *Report of Proceedings* 227-228.

goodwill,[12] and 2.1% of its employees were located in Illinois, where it had an operational headquarters for one of its divisions. J.A. 14; 99; 104; 189. Lexis/Nexis had contracts with Illinois customers which generated $40.7 million in annual receipts. J.A. 189. As in the case of trademarks, which represent goodwill, the value of goodwill cannot be separated from the business itself as an economic matter. Cf., *Visa, U.S.A., Inc. v. Birmingham Trust National Bank*, 696 F.2d 1371 (C.A. Fed. 1982), *cert. den.*, 464 U.S. 826 (1983).

The Taxpayer's intangible property thus had a taxable business situs in Illinois, and as such, income from its disposition was properly subject to Illinois' taxing power, as a long line of this Court's precedents have held. In the seminal case of *Adams Express Co. v. Ohio*, 165 U.S. 194, 223-224 (1897) this Court directly confronted the question of where a unitary business' intangible property is "located" for purposes of apportioning value for property tax purposes:

> [i]s it simply where the home office is, where is found the central directing thought which controls the workings of the great machine, or in the State which gave

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[12] For instance, in its 1993 Annual Report, the Taxpayer announced: "Sales from the business information services area led the way for [Lexis/Nexis] as it aggressively targeted new business while strengthening relationships with existing customers." J.A. 81.

> it its corporate franchise, or is that intangible property distributed wherever its tangible property is located and its work is done? Clearly, we think the latter.

The rule announced in *Adams Express* for assigning intangible property values to where the enterprise conducts its operations has been followed in the context of income taxes, both as a federal constitutional matter and as a matter of state law. Thus, in *Whitney v. Graves*, 299 U.S. 366 (1937), this Court held that New York could impose an income tax on an out-of-state resident on the capital gain received from the sale of a membership on the New York stock exchange. This Court wrote in that case:

> When we speak of a 'business situs' of intangible property in the taxing State we are indulging in a metaphor. We express the idea of localization by virtue of the attributes of the intangible right in relation to the conduct of affairs at a particular place.

299 U.S. at 372. See also, *Wheeling Steel Corporation v. Fox*, 298 U.S. 193 (1936)(intangible property acquires a taxable business situs where employed); *Curry v. McCanless*, 307 U.S. 357, 367 (1939)(same). The "intangible" at issue in this case is the value of the on-going business conducted in multiple States, including Illinois; the value of that property cannot be localized in the Taxpayer's commercial domicile. Accord, *A&F Trademarks, Inc. v. Tolson*, 605 S.E.2d 187 (N.C. App. 2004); *Kmart*

Properties, Inc. v. Taxation and Revenue Dep't., 139 N.M. 177, 131 P.3d 27 (N.M. Ct. App. 2001), *writ quashed, rev'd in part*, 131 P.3d 22 (N.M. 2005).

1. Illinois' Tax Can Be Sustained Even in the Absence of a Unitary or Operational Connection to Mead Paper's Business Activity in Illinois Where There is a Unitary or Operational Connection to Lexis/Nexis' Business Activities Within the State.

That the State has a right to impose its income tax based on the in-state source of that income should be beyond dispute. *Allied-Signal*, 504 U.S. at 778; *Exxon Corporation v. Wisconsin*, 447 U.S. at 229; *International Harvester Company v. Wisconsin Department of Revenue*, 322 U.S. 435 (1944); *Whitney v. Graves*, 299 U.S. 366 (1937); *Shaffer v. Carter*, 252 U.S. 37, 52 (1920); See also, Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective*, 45 William & Mary L. Rev. 319, 363 (2003)("the Court in *International Harvester* and *Whitney* strongly adhered to the principle of source taxation, and, more generally, to acknowledging the primacy of economic substance in income tax matters."); J. Hellerstein & W. Hellerstein, *State Taxation* ¶ 6.04, 6-13 (3rd ed., 2006). Nor is there any question in this case as to the State's jurisdiction over the Taxpayer (as opposed to the income), since the Taxpayer engaged in substantial business in the State and availed itself of the State's protections. See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

All of this Court's modern cases involving the application of the unitary business principle, including *F.W. Woolworth Co. v. New Mexico*, 458 U.S. 354 (1982), *ASARCO v. Idaho, and Container*, have done so in the context of income which arguably had its source outside of the taxing jurisdiction, for, as this Court has repeatedly held, the relevant question is whether the State has impermissibly taxed extraterritorial values by including that income in the apportioned base. Accord, *Bass, Ratcliff, & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924); *Butler Brothers v. McColgan*, 315 U.S. 501 (1942). Thus, in *ASARCO v. Idaho* the question was presented as:

> whether the State of Idaho constitutionally may include within the taxable income of a non-domiciliary parent corporation doing some business in Idaho a portion of intangible income—such as dividends and interest payments, as well as capital gains from the sale of stock that the parent corporation receives from subsidiary corporations *having no other connection* with the taxing State.

458 U.S. 307, 308-9 (emphasis added). In *F.W. Woolworth Co.*, 458 U.S. 354, 356 (1982), the opening question was framed as: "whether the Due Process Clause permits New Mexico to tax a portion of dividends that appellant F. W. Woolworth Co. received from foreign subsidiaries *that do no business in New Mexico.*" (emphasis added). This Court concluded that:

> New Mexico, in taxing a portion of dividends received from such enterprises, is attempting to reach "extraterritorial values," Mobil, supra, at 442, wholly unrelated to the business of the Woolworth stores in New Mexico. As a result, a "showing has been made that income unconnected with the unitary business has been used in the" levy of the New Mexico tax. *Butler Bros. v. McColgan*, 315 U.S. 501, 509 (1942). We conclude that this tax does not bear the necessary relationship "`to opportunities, benefits, or protection conferred or afforded by the taxing State. *See Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444.

Id. at 372. In *Mobil Oil v. Vermont*, the dividend income in question was from "subsidiaries and affiliates doing business abroad." 445 U.S. at 427. In *Container*, the issue was whether apportionment of the income and factors of allegedly more-profitable foreign subsidiaries combined with domestic operations resulted in an overstatement of California income. 463 U.S. at 180-186. In *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. at 212, the question presented was whether Wisconsin could include in its apportioned tax base income derived from exploration, production and refining operations all of which took place outside the State.

And in *Allied-Signal*, the question presented was whether New Jersey could impose an appor-

tioned tax on investment income unconnected with the taxpayer's unitary business activity carried out in the State. [13]

In each of these cases, reference to unitary business principles was necessitated precisely because there was no other connection between the income and the taxing State; in the absence of such a connection, apportionment raised the potential for extra-territorial taxation. The on-going substantial presence of Lexis/Nexis within Illinois distinguishes this case from those cited above. Where such a direct connection exists between the income source and the State, reliance on any operational connections the income may have with other activities carried on by the Taxpayer in the State is unnecessary.

Because the imposition of tax in this case may be sustained independently of any unitary or func-

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[13] The Taxpayer may note that the investee corporation, ASARCO, was incorporated in New Jersey, although it appears its commercial domicile was elsewhere. Because New Jersey hoped to sustain its tax on a theory of full apportionment, it did not raise ASARCO's connection with the taxing state as an alternative basis to sustain the tax. See Hellerstein, *State Taxation of Income from Intangibles: Allied-Signal and Beyond*, 48 Tax L. Rev. 739, 787 (1994). This Court's analysis suggests that an independent connection to the investee's business activities could support taxation. When providing an example of how income received from a non-unitary source could still be apportioned if it had an operational connection to the taxpayer's unitary business conducted in the taxing state, this Court provided a hypothetical involving a short-term deposit of working capital in an unrelated *out-of-state* bank. 504 U.S. at 787.

tional connection between Lexis/Nexis and Mead Paper, the proper focus of this Court's inquiry should be whether Illinois' tax has impermissibly burdened interstate commerce. In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), this Court established a four-part test for judging the validity of a State tax on activities in interstate commerce: (a) is the tax upon activity with a substantial nexus to the taxing State; (b) it is fairly apportioned; (c) is it non-discriminatory; and (d) is the tax fairly related to benefits and protections afforded by the State? 430 U.S. at 279-80.

Illinois' tax unequivocally meets all four prongs of the *Complete Auto* test. First, the incidence of the tax is the sale of assets located partially in Illinois. Second, the tax is fairly apportioned, since the percentage of the gain which was taxed is nearly identical to Lexis/Nexis' presence in the State. Third, the tax is non-discriminatory; if every State imposed its tax based on Lexis/Nexis' in-state presence, no double-taxation would occur. Finally, the tax is fairly related to the benefits and protections Illinois provided to the Taxpayer.

Although the Taxpayer has chosen to devote the entirety of its brief to addressing what it believes is a lack of operational connection between the two business segments, it should not come as a surprise to it that a second and independent basis to tax exists. This issue was raised in the circuit court proceedings below. See *State's Supplement to Defendant's Post-Trial Brief*, Record Vol. 8, C1887-8. The circuit court agreed with the State's argument,

making a mixed factual/legal conclusion in its *Memorandum Decision, Judgment and Order:*

> [t]he sale of Lexis/Nexis included assets which were situated in Illinois and used in the production of income reported to Illinois. That activity provides a nexus between Illinois and Lexis/Nexis which reaches the gain on the sale. Work papers provided by Mr. Murray and the report provided by Mr. Yano both show that there were assets, personnel and sales of Lexis/Nexis in Illinois for the 1994 year.

Record Vol. 8, C1929. Then as now, the Taxpayer can cite to no authority for its contention that a State loses its authority to tax a non-domiciliary's income generated within its borders when the income is recognized as a capital gain. Nothing in *Whitney v. Graves* suggests a basis for a constitutional distinction between taxing the owner of intangible property on income derived from property in the form of earnings and income derived in the form of a capital gain. As this Court held in *Complete Auto Transit*, the States' right of taxation under the Commerce Clause is not conditioned upon the label or classification which might be attached to that income. 430 U.S. at 288-9.

2. Because Illinois Has Provided Protections to Lexis/Nexis, the State Could Tax an Apportioned Share of the Gain in this Case Even if Mead Paper Merely Invested in Lexis/Nexis and Had No Other Connection to the Taxing State.

Finally, even if the Court accepted the Taxpayer's contention that it operated only a single business, Mead Paper, and chose to discount the Taxpayer's representations to the public, investors and tax authorities that it operated Lexis/Nexis as a business (J.A. 59; 92-93; 106-108; 120-21), Illinois could still assert jurisdiction over that income as a constitutional matter. This point was brought home in *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940) and *International Harvester v. Wisconsin, supra.* In both cases, this Court upheld Wisconsin's tax on dividends paid from non-domiciliary corporations doing business in the State where the incidence of the tax fell on shareholders. In both cases, this Court noted that the tax was justified by the protections and benefits provided to the investors' in-state property. See also, *Allied-Signal, Inc. v. Commissioner of Finance (New York),* 79 N.Y. 2d 73, 588 N.E. 2d 731 (N.Y. 1991); *Cf., Borden Chemicals & Plastics, LLP v. Zehnder*, 312 Ill. App. 3d. 35, 726 N.E. 2d. 73 (2000)(taxation of distributed share of income to non-resident partner of pass-through entity).

C. Any Danger Of Double Taxation Is Avoided By This Court's Default Rule Preferring Apportionment To Allocation Where Both The Domiciliary And The Source States May Tax The Income

The intangible assets of Lexis/Nexis were operationally connected to its business and thus the capital gain from their sale is unitary business income subject to apportionment under *Allied-Signal*. Under normative rules for state income taxation as embodied in the Uniform Division of Income for Tax Purposes Act ("UDITPA"), the gain from the sale of assets used in a unitary business is not classified separately from ordinary operating income for purposes of apportionment. UDITPA, Sections 1 & 9, *reprinted in*, J. Hellerstein & W. Hellerstein, *State Taxation*, Appendix A, pp. A1-A11. (3rd ed. 2006). There is no special rule for separately apportioning or allocating business income arising from intangible property, or business income designated as capital gains, although the sales factor is adjusted where possible to reflect the source of intangible income. *Id.*, Section 17; Multistate Tax Commission Model Regulation IV.18(c)(3), *reprinted in*, *State Taxation*, Appendix B, p. B-38. Thus, if all States in which Lexis/Nexis did business taxed an apportioned share of this gain based on that business' presence in the State, no duplicative taxation would occur.

Mead's contention that the gain on the sale of Lexis/Nexis assets should default to Ohio, Mead's domicile, goes against this Court's jurisprudence fa-

voring apportionment of unitary income, and could lead to double taxation.

This Court has made clear that, where multiple States have the power to tax unitary income on an apportioned basis, allocation of that income is disfavored. *Mobil Oil*, 445 U.S. at 444 (rejecting taxpayer's argument that income from intangibles should be allocated rather than apportioned so as to avoid double taxation). The possibility of double taxation caused by conflicting state tax sourcing rules is not enough to strike down a State's apportioned tax in the absence of demonstrated extraterritorial taxation. *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978). When the two approaches are equally constitutionally supportable, this court has favored apportionment, and not, as the taxpayer proposes, allocation. In *State Taxation*, ¶ 6.03, the authors note:

> Although the source principle is more circumscribed than the residence principle in a geographic sense, it is the dominant principle in cases of conflict between residence and source principles. In other words, when both the state of domicile and the state of source have a legitimate claim to tax income, the state of domicile ordinarily yields to the state of source to avoid double taxation. This is true both as a matter of national and international practice, and as a matter of federal constitutional law.

See also, W. Hellerstein, *State Taxation of Corporate Income from Intangibles, Allied-Signal and Beyond*, 48 Tax L. Rev. 739, 804-5 (1993), and cases cited therein.

Because Illinois clearly has the power to tax a properly-apportioned share of the gain on the sale of Lexis/Nexis, this Court's apportionment jurisprudence would disfavor the allocation of 100% of that gain to one State.[14] The rule urged by the Taxpayer in this case – that gain on the sale of the assets functionally connected to the operation of a unitary business in multiple states be allocated to the domiciliary state – would confuse the Court's current clear preference and open the door for potential double taxation.

In addition, as the facts of this case illustrate, abandonment of source-based principles for income taxation would encourage taxpayers to transfer the ownership of business assets to a separate subsidiary domiciled in a no-tax or low-tax jurisdiction prior to sale, thus converting apportionable unitary income into income that is allocable wherever a taxpayer would like to allocate it. The Taxpayer's default rule

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[14] It bears repeating that it is not at all clear that Ohio in fact allocated 100% of the gain on the sale of Lexis/Nexis to itself. Petitioner's Brief strongly suggests otherwise. Pet. Br. 53 n. 13. It is likely that Ohio, like Illinois, would treat the gain as apportionable business income. *See, e.g, Kempel v. Zaino*, 746 N.E. 2d 1073, 1075 (Ohio 2001).

is not tailored to avoid double taxation. It is tailored to encourage "nowhere" income.

Furthermore, this Court's default rule favoring source state apportionment as a matter of constitutional law is consistent with soundly reasoned state tax policy. In *State Taxation*, the authors note, in the context of describing the "functional test" for business income under UDITPA:

> [G]ain from the disposition of property used in the taxpayer's business represents recoupment of expenses deducted from apportionable income while the property was used in the business... . It would be incongruous (and, from the state's standpoint, inequitable) for a taxpayer to be able to reduce in-state apportionable income through ... deductions while the asset was being used in the ... business and then, when the asset is sold, to avoid "recapture" of that income in the state by treating the income from the sale as nonbusiness income allocable to another state.

State Taxation ¶9.05[2][c], at 9-44 – 9-45.[15]

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[15] Professor Hellerstein is of the view that state tax policy strongly supports a functional test but he could not find support for such a test in the statutory language. A number of courts have found otherwise. *See, for example, Hoechst Celanese Corporation v. Franchise Tax Board*, 25 Cal. 4th 508, 22 P. 3d 324, 106 Cal. Rptr. 2d 548, *cert. den.*, 534 U.S. 1040 (2001). In this case, the Taxpayer's claim that this gain gave rise to non-

This recognition of a capital gain as a recoupment of apportionable business expenses further demonstrates why there is no constitutional basis for a distinction between sourced-based taxation of capital gains and operating income. In fact, the record in this case provides a clear example of the connection between operating income and capital gains. The Taxpayer's 1993 Annual Report to Shareholders announced that:

> Mead Data Central [Lexis/Nexis] revenues grew 11% in 1993. However, strategic investments to enhance the features and functionality of its services, as well as expenditures for new product development and sales force restructuring, offset the effect of sales growth resulting in little earnings change from 1992.

J.A. 67. The improved business operations which resulted from those investments decreased current apportionable income but increased the business' value and the resulting goodwill of the business, leading to a higher capital gain when the business assets were sold in the following year. In essence, the reinvestment of the revenues into business operations amounted to a decision to defer profits and the taxes on them until the business was sold. The operational source of the profits did not

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business income under Illinois law has been rejected by the Illinois Court of Appeals. Pet. App. 18a.

change. The close interrelationship between current earnings and capital gains in this example confirms this Court's wisdom in predicating taxing authority on economic substance instead of accounting classifications.

The Court's existing default rule in favor of source-based taxation over domiciliary-based taxation is sound both as a matter of constitutional law and as a matter of state tax policy. Petitioner has adduced no sound reason to change that default rule and this Court should decline to do so.

CONCLUSION

For the reasons set forth above, *Amicus Curiae* Multistate Tax Commission urges this Court to affirm the decision of the Illinois Court of Appeals.

Respectfully submitted,

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December 10, 2007